IN THE

SUPREME COU
UNITED ST
OCTOBER TERM

CITIES SERVICE GAS COMPANY,
Petitioner,

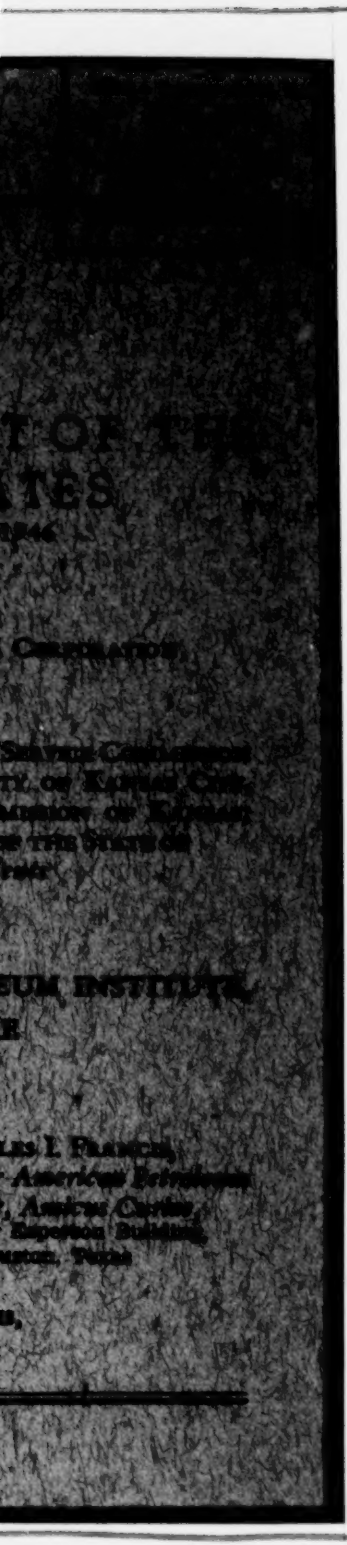
vs.

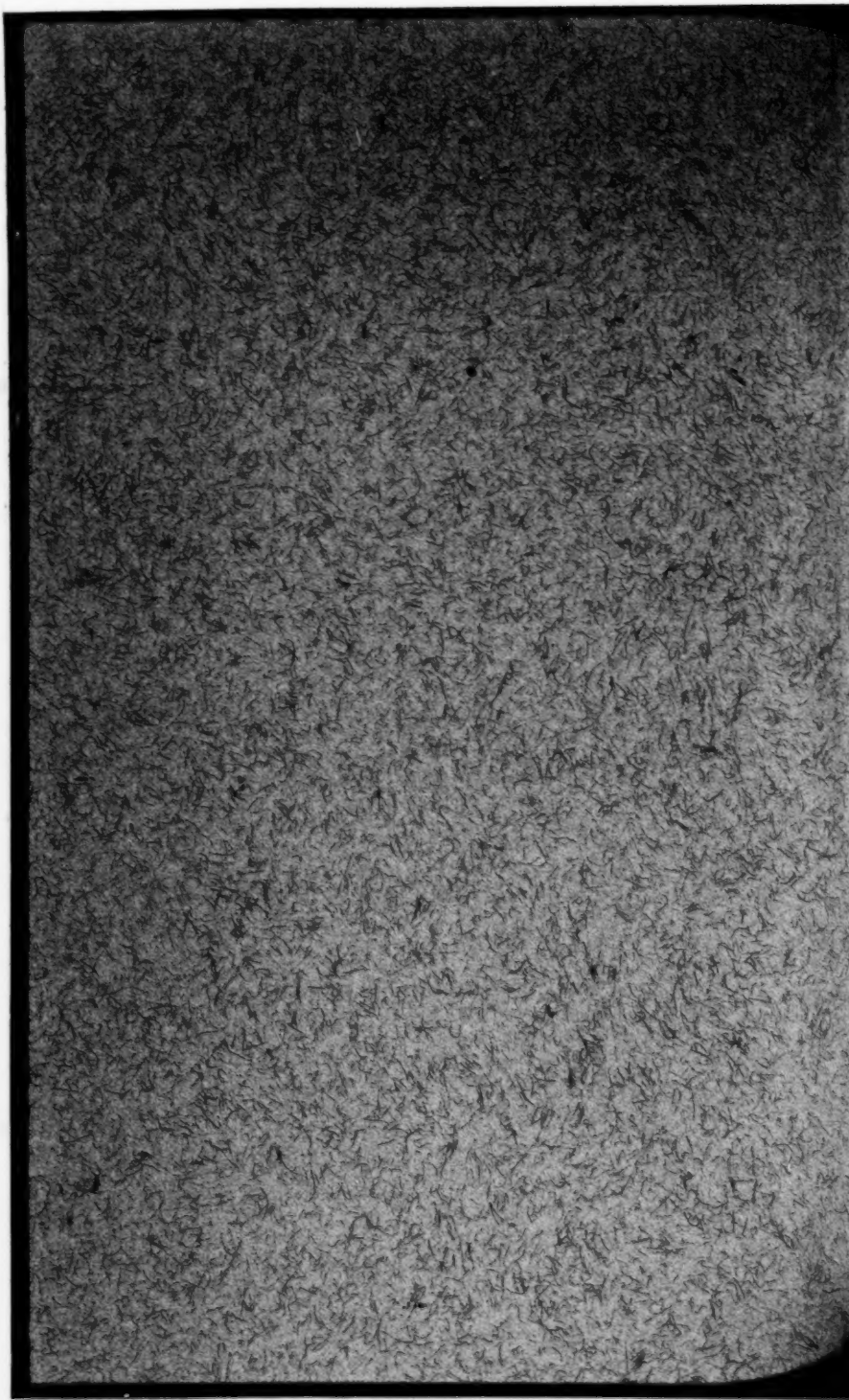
FEDERAL POWER COMMISSION; PUBL
OF THE STATE OF MISSOURI; THE
MISSOURI; STATE CORPORATION CO
AND CORPORATION COMMISSIO
OKLAHOMA,

BRIEF OF AMERICAN PETRO
AMICUS CURI

CH
Attorney f
Institu
11th Flo

Of Counsel:
VINSON, ELKINS, WEEMS & FRAN
3200 First Republic Bank Plaza
Dallas, Texas





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No. 556

IN THE

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OCTOBER TERM, 1946

CITIES SERVICE GAS COMPANY, A CORPORATION,
Petitioner,

vs.

FEDERAL POWER COMMISSION; PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI; THE CITY OF KANSAS CITY, MISSOURI; STATE CORPORATION COMMISSION OF KANSAS; AND CORPORATION COMMISSION OF THE STATE OF OKLAHOMA, *Respondents*

MOTION TO FILE BRIEF, AGREEMENT OF PARTIES AND CERTIFICATE OF SERVICE

To the Honorable Supreme Court of the United States:

The American Petroleum Institute requests permission to file the attached amicus curiae brief in said above styled and numbered cause, hereby certifying that permission of all parties to said cause (except the City of Kansas City, Missouri) has been secured, and that copies of this brief have been mailed, properly addressed, with first-class postage prepaid, to each of the following:

Mr. Leon M. Fuquay,
Secretary,
Federal Power Commission,
Washington, D. C.

Hon. George T. Washington,
Acting Solicitor General of
the United States,
Department of Justice,
Washington, D. C.

General Counsel
Corporation Commission of
State of Oklahoma,
Capitol Building,
Oklahoma City, Oklahoma

General Counsel
Public Service Commission of
Missouri,
Capitol Building,
Jefferson City, Missouri

Mr. Jerome M. Joffee,
Special Utilities and Legislative Counsel, City of Kansas City,
Municipal Building,
Kansas City, Missouri

General Counsel
State Corporation Commission of Kansas,
Capitol Building,
Topeka, Kansas

The City of Kansas City, Missouri, was not an original party to the case but intervened when the case was pending in the United States Circuit Court of Appeals. The Acting Solicitor General of the United States, representing the real party in interest, the Federal Power Commission, has executed a consent agreement along with all other named parties.

DATED at Houston, Texas, this_____day of December, 1946.

CHARLES I. FRANCIS,
Attorney for American Petroleum Institute, Amicus Curiae,
Houston, Texas
11th Floor Esperson Building.

Of Counsel:

VINSON, ELKINS, WEEMS & FRANCIS,
11th Floor Esperson Building,
Houston, Texas

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BRIEF OF AMERICAN PETROLEUM INSTITUTE, AMICUS CURIAE

In Support of Petition for Rehearing on Denial of Petition for Writ of Certiorari

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This brief is presented by the American Petroleum Institute, a corporate organization, representing generally and extensively all branches of the oil and gas industry. Its membership, consisting of about 5,000 members of the oil and gas industry, reaches into every state of the Union, and includes producers of crude petroleum and natural gas, refiners of

petroleum and its products, transporters of crude petroleum or its products, or natural gas through pipelines, owners of oil and gas royalties, land owners and many others engaged in some branch or branches of the oil or gas business. Because of the very close interrelation in the discovery, production, transportation and sale of oil and natural gas, virtually all members of this Association and all others similarly engaged in the oil and gas industry, are affected by and concerned in the legal problems in connection with the "production and gathering" of natural gas and other related problems herein referred to.

By reason of its very real, immediate and extensive interest in such problems, the Institute took an active part in the proceedings initiated by the Federal Power Commission, entitled: Natural Gas Investigation, Docket G-580, to investigate "the interstate aspects" of the natural gas industry. In that proceeding many hearings were held, both in gas-producing and gas-consuming areas of the United States, during the year 1946, where the various questions here under discussion were extensively presented.

Since the production of oil and the production of gas are so interrelated, the failure of the courts, and particularly of this Court, to clarify, settle and dispose of the various questions involved in this case, inevitably now does and will continue substantially to affect and actually to curtail much exploration and development and the consequent sales and utilization of natural gas. This is true whether natural gas is produced locally by a "natural gas company," under the Gas Act, or by other producers of gas or the many producers of petroleum also producing natural gas. Producers other than producing interstate pipelines have not been regulated by the Federal Power Commission as yet, but the conviction is widespread throughout the country that the Commission,

in its desire to enlarge its own powers, will bring them within the scope of its regulations. Such result certainly seems highly probable in view of the present trends and developments in Commission and judicial action, procedure and decision. The specific and controlling provisions of the Natural Gas Act have been overlooked and forgotten in this program of expanding Federal regulation.

The broad questions presented in this case, in which this Association is thus vitally concerned, arise out of a rate reduction order of the Federal Power Commission; the judgment of the Circuit Court of Appeals for the Tenth Circuit, affirming that Commission order on April 30, 1946 (155 Fed. (2d) 694); and the order of this Court, refusing to grant certiorari herein.

The fundamental issues as to which the Institute has such direct, specific and immediate interest and concern are:

I.

The inclusion of the production and gathering properties, including natural gas reserves, of the petitioner in this case and, therefore, of every producing "natural gas company," in the Commission-determined utility rate base. This includes not only that portion (undefined) of those properties devoted to the regulated business and operations, but the remaining portion thereof devoted to its non-regulated business and operations as well.

II.

The exclusion, *as a matter of law*, by the Commission trial examiner, approved by the Commission and by the Court of Appeals, of all evidence of "value" of such production properties, including natural gas reserves, and the adoption of Commission "cost," *as a matter of law*, as the sole criterion for the determination of the utility regulated rate base.

III.

The Commission appropriated all earnings of an affiliated company which is separate and distinct, both in operation and corporate entity from the petitioner herein, arising out of the extraction of natural gas gasoline from certain of the natural gas produced and sold by petitioner, under contract between the petitioner and such affiliate. The earnings so appropriated were designated by the Commission, with the approval of the Court of Appeals, as "excess earnings." The amount thereof was determined by imposing upon the Commission-segregated natural gas gasoline extraction plants and operations of the affiliate, in a separate rate case to which the affiliate was not a party, the Commission "cost" rate base of such properties. The Commission procedure in that behalf was identical with the procedure followed by it in this rate case of the petitioner as a regulated "natural gas company" under the Act. The excess of such earnings of the affiliate from such operations, also as fixed by the Commission, over and above 6½% on the Commission-imposed "cost" rate base, was designated as "excess earnings." The affiliate is not a "natural gas company" under the Act, and is not subject otherwise to the authority of the Federal Power Commission. Such so-called "excess earnings" were credited to the expense account of the petitioner, thus reducing its actual expenses and the Commission "cost of service allocation" base by such credit and increasing the petitioner's purported net earnings by the same amount.

IV.

The evident disposition of the courts to endow Commission action with the attribute of finality, notwithstanding the governing and established principles of law which Con-

gress, in Section 19(b) of the NATURAL GAS ACT, declared should be applicable.

The remaining questions in this case, as disposed of by Commission and Court of Appeals, relating to "existing depreciation," "Federal income taxes," "allocation" and the right to actual though limited judicial review before a Court of Appeals and before this Court, also are of direct concern to all enterprises now regulated by the Commission and to all others which the Commission hereafter may seek to subject to its regulation.

However, the brief discussion herein, supplementing the presentation thereof by petitioner in its petition for certiorari and supporting briefs, will be limited to the four broad fundamental issues above enumerated.

Discussion

I.

Asserted Jurisdiction of the Commission Over "the Production or Gathering of Natural Gas"

Section 1(a) and (b) of the GAS ACT delegate to the Commission regulatory authority over "transportation of natural gas in interstate commerce" and over "the sale in interstate commerce of natural gas for resale * * *," and over no other operations, activities or properties. Affirmatively and expressly Section 1(b) of the ACT provides: "*The provisions of this Act * * * shall not apply* to any other transportation or sale * * * or *to the production or gathering of natural gas.*" This "shall not" limitation expressly relates to the entire Act.

Nevertheless the Commission has exercised *regulatory authority* over all production and gathering properties, opera-

tions and business, including natural gas leaseholds and reserves of the petitioner herein. This action of the Commission the Court of Appeals, in this case, has declared to be proper and lawful under the Gas Act (R. V. 3, pp. 1328-1329), on the asserted authority of the decision of this Court in CANADIAN RIVER GAS CO. v. FEDERAL POWER COM., 324 U.S. 581, 65 S. Ct. 829.

That case, in which the Commission had included "the production and gathering facilities" and as a part thereof all natural gas lands, leaseholds and reserves of Canadian in the so-called utility rate base, was affirmed in this Court by a five to four decision. Of the five justices who participated in the affirmance, four speaking through MR. JUSTICE DOUGLAS declared that certain other sections of the Act required disregard of the clear and direct *jurisdictional* limitation and mandate of Section 1(b) of the Act. "We must read Section 1(b) in the context of the whole Act," said Mr. JUSTICE DOUGLAS. With this philosophy of statutory construction, MR. JUSTICE JACKSON, whose vote was necessary for affirmance of the case, did not agree. He took the position that "If the Commission had imposed any direct regulation upon that activity, I would join in holding it to have exceeded its jurisdiction." Such also was his view respecting the analogous "shall not" provisions of Section 201(b) of the Power Act (CONNECTICUT L. & P. CO. v. FEDERAL POWER COMM., 324 U.S. 515, 65 S. Ct. 749). Thus in the CANADIAN case there was no authoritative determination by a majority of the Court supporting the exercise by the Commission of regulatory jurisdiction over production and gathering (UNITED STATES v. PINK, 315 U.S. 203, 62 S. Ct. 552).

In the CANADIAN case it was also the view of MR. JUSTICE JACKSON that the inclusion of the production and gathering properties and operations in the regulated rate base was the investigation of the "fiscal aspects" of such business and con-

stituted the taking of "evidence as to conditions and events quite beyond its regulatory jurisdiction where they are thought to affect the cost of that whose price it is directed to determine." On this ground he joined in the affirmance upon the question of jurisdiction. With this conception none of the other eight members of this Court agreed. MR. JUSTICE DOUGLAS and his three concurring associates and the late MR. CHIEF JUSTICE STONE and his three concurring associates, all concurred in the conclusion that the inclusion of such properties in the utility rate base, *in fact*, was the exercise of direct regulatory jurisdiction over production and gathering. The only disagreement between these two groups on the jurisdictional issue was the question of legality or illegality of the Commission action.

Furthermore, the identical contention made by MR. JUSTICE JACKSON in the CANADIAN case was laid at rest by CHIEF JUSTICE WHITE, speaking for the entire Court, in SOUTHERN PACIFIC CO. v. INTERSTATE COMMERCE COMM., 219 U.S. 433, 31 S. Ct. 288. It was there held that the character of the power which the Commission actually exercised was determined by the nature and substance of the order under review. *Here, precisely the same regulatory control, procedure and order were applied to the production and gathering properties and business as to the admittedly regulable properties and business. Regulation is regulation by whatever name it may be designated.*

On such a state of uncertainty as to the meaning and effect of Section 1(b) of the NATURAL GAS ACT, which on its face is entirely plain and definite, the broad and public necessity for a clear and unequivocal determination by this Court of that jurisdictional question, which is presented directly in this case, is abundantly apparent.

II.

The exclusion, as a matter of law, by the Commission, with the approval of the Court of Appeals, of all evidence of "value" of natural gas reserves in its determination of the controlling rate base, which included such properties at zero or at merely nominal amounts.

This question is not a corollary of the issue of Commission jurisdiction above considered. It is asserted by the Commission, its staff and its counsel that the Commission is *required, as a matter of law*, by Section 6(a) of the NATURAL GAS ACT, to use "cost" and only "cost" in its determination of rate base and rates. "Value," it seems, may be considered only in a case where "the exigencies of the particular situation require such a determination," which exigency, according to the record in this case, cannot arise if "the actual legitimate cost of these leases can be determined from the books" (R. V. 1, pp. 31-32, 152-153, 161, 163, 164, 165-166, 183-184, 385-387). The viewpoint of the Commission in laying down its rigid rule outlawing "value" is stated in its opinion as follows: "Our views as to why such evidence should be excluded have been stated in earlier opinions, and need not be amplified here" (R. V. 1, p. 31).

This Court repeatedly has declared to the contrary that "the Commission was not bound by the use of any single formula in determining rates" (FEDERAL POWER COMM. v. NATURAL GAS PIPELINE COMPANY, 315 U.S. 575, 62 S. Ct. 736; CANADIAN RIVER GAS CO. v. FEDERAL POWER COMM., 324 U.S. 581, 65 S. Ct. 829).

Thus, the Commission's total exclusion of all evidence of "value" of gas reserves rested upon a misconception of the law. Not having followed "the correct rule of law" (CON-

NECTICUT L. & P. Co. v. FEDERAL POWER COMM., supra), its order must be set aside.

The question of "value" of natural gas reserves presented in this record has not been resolved and determined in any decision of this Court. In the CANADIAN case MR. JUSTICE DOUGLAS, speaking for himself and his three concurring associates, declined to consider that question in that case on the ground that it "could be determined only on consideration of the end result of the rate order, a question not here under the limited review granted the case." Nor was the issue of "value" of gas reserves involved in the case of FEDERAL POWER COMMISSION v. HOPE NATURAL GAS COMPANY, 320 U.S. 591, 64 S. Ct. 291. This was pointed out by MR. JUSTICE JACKSON in the CANADIAN case (324 U.S. at 645, 65 S. Ct. 308), and by JUDGE PHILLIPS in his dissenting opinion in this case (R. V. 3, p. 1347).

Here, then, is a fundamental and far-reaching issue of wide and general importance, to-wit: Whether, assuming Commission regulatory jurisdiction over the production and gathering properties and operations of a "natural gas company," the Commission lawfully may exclude all evidence of "value" of natural gas reserves in the rate case hearing preliminary to determination of rate base. It would seem clear from what this Court has declared on the subject that it may not do so, and yet, in this case where the Commission did that precise thing, this Court, no doubt inadvertently, has denied writ of certiorari to correct such far-reaching and serious error of law indulged by both Commission and Court of Appeals.

This Court of course recognizes the fact that the application of the fixed "cost" formula of the Commission to natural gas reserves also substantially will affect and operate to unsettle and confuse the market price of natural gas as a commodity. This is a matter of impressive and wide im-

portance. The confusion results from the fact that most producer-pipelines presently are obliged to *give away* much of their annual production because there is no return allowed on reserves incorporated into the utility's rate base at zero dollars and virtually no return on those reserves included in such rate base at nominal "cost." The result of the Commission concept is that the price of natural gas as a commodity depends upon who produces that gas. There is neither economics nor sense in such a dual price standard, and it is one which the legislative history of the Natural Gas Act shows Congress did not intend, but did intend should not result.

III.

The expropriation by the Commission, acquiesced in by the Court of Appeals, of the Commission-determined so-called "excess profits" realized from the extraction of natural gas gasoline from a portion of petitioner's produced and purchased gas, by an affiliate company under contract with petitioner.

The procedure followed by the Commission in this matter is sufficiently detailed for present purposes in the statement of Point III, supra.

In treating the separate and disassociated extraction plants, properties and operations of petitioner's affiliate "as if they belonged to petitioner" (R. V. 2, pp. 792, 802) and thereupon subjecting them to the same direct and specific rate-regulatory processes utilized in the regulation of petitioner's regulable rates, the Commission embarked on nothing other or less than "regulation." The segregation of such extraction plants and business from the other properties and operations of the affiliate, the fixation of a depreciated "cost" rate

base thereof, the allowance or disallowance of expenses chargeable against gross revenue, the determination of total net earnings, the fixation of an allowable rate of return, and the disallowance of all profits in excess of the allowed rate of return ($380,000 a year) (R. V. 1, pp. 53-54) are the devices, implements and end results of regulation. They are direct regulation of the property and business of the affiliate, clearly not subject to regulation by the Commission. This fact cannot be altered or dissipated by words or by straining logic to absurd extremes (SOUTHERN PACIFIC CO. v. INTERSTATE COMMERCE COMM., 219 U.S. 433, 31 S. Ct. 288). Congress did not grant the Commission any such jurisdiction.

The Commission made no effort whatever "to make any adjustment in the price" paid by the affiliate to petitioner for the processed gas (R. V. 2, p. 802). The principle of law that commission and court alike may inquire into the reasonableness of contracts between affiliates and adjust the contract to conform to "arm's length dealings" was disregarded entirely throughout this case.

The contention is made by Commission counsel (COMM. BR., p. 17) as well as by the Court of Appeals (R. V. 3, p. 1336), to support the Commission exercise of this direct rate-regulatory control over the gasoline extraction plants and operations of the affiliate, that otherwise a regulated gas utility would be enabled "to syphon off profits to nonregulated affiliates." This argument does not stand up. Heretofore, in many cases and as a matter of established procedure, commissions and courts alike, *without attempting to exercise regulatory control over the non-regulated affiliate,* have made inquiry into and required that the contractual relations between affiliates be reasonable and equivalent to "arm's length dealings." Such is the law (SMITH v. ILLINOIS BELL TEL. CO., 282 U.S. 133, 51 S. Ct. 65; UNITED FUEL GAS CO. v. RAILROAD COMM., 278 U.S. 300, 49 S. Ct. 150;

dissenting opinion, CHIEF JUSTICE STONE, in CANADIAN RIVER GAS COMPANY case, 324 U.S. 581, 65 S. Ct. 829).

Neither the Natural Gas Act nor any established principle of law contemplates or permits the Commission procedures here under consideration. Here is action by a federal administrative agency in excess of its authority under a federal statute which a federal circuit court of appeals refuses to redress. Such a "special and important" situation should move this Court now to take jurisdiction in the exercise of its "sound judicial discretion."

IV.

Denial of Judicial Review Under Section 19 (b) of the Natural Gas Act

This amicus curiae is convinced, if review on certiorari be not granted in this case, wherein the "special and important reasons" therefor and the considerations of "gravity and general importance" are so numerous and clear, that the statutory review under the Natural Gas Act becomes a virtual nullity.

There are here present: principles of law, statutory interpretations and serious issues, all unsettled, undetermined and in confusion; abuse and overreaching of its statutory authority by the Commission; refusal of the Court of Appeals on the plea of impotency to perform its mandated functions and duties as the court of review; disregard by Commission and Court of Appeals alike of established and prevailing principles and rules of law; and a Commission opinion without adequate findings and containing findings without record support. Each of such principles and issues is of special importance and general gravity and concern.

WHEREFORE, respectfully this Court is requested and urged to grant writ of certiorari herein.

CHARLES I. FRANCIS,
Attorney for American Petroleum Institute, Amicus Curiae,
11th Floor Esperson Building,
Houston, Texas

Of Counsel:
VINSON, ELKINS, WEEMS & FRANCIS,
11th Floor Esperson Building,
Houston, Texas